Journal of Accountancy

Volume 70 | Issue 1 Article 16

7-1940

Book Reviews

Maurice E. Peloubet

J. S. Seidman

William F. Connelly

BOOK REVIEWS

FINANCIAL SECURITY IN A CHANGING WORLD, by Merryle Stanley Rukeyser. *Greenberg: Publisher*, New York, N. Y. 272 pages. 1940. $2.50.

There is nothing in this book which is new or startling or strange. It proposes no cure-alls and presents no special theories. On the other hand, the author does not propose to meet present conditions by principles and ideas which were current and effective in 1914 or 1918. "Forward looking" is, of course, now almost a term of reproach but the "forward looking" presented here is the right sort based on a realization that if we honestly try to understand what is happening, we may be able to see a little way ahead and the extent to which we can see ahead will probably determine our financial and economic position.

The book is so simply and clearly written that it can be read through, almost without a pause, with sustained interest. Students of economic and accounting literature know how rarely this is true of a book in those fields. Basic economic and financial factors which effect the life of almost everyone are expressed in terms that almost anyone can understand. In some ways, the author's approach and method are not unlike that of Jonathan Swift in *The Drapier's Letters*, that remarkable explanation, intelligible to anyone who can read, of the effects of a debased currency.

His chapters on "Beware of Headline Economics" and on insurance are examples of this. The rather involved connection between a depositor in a savings bank or the holder of a small insurance policy and the action of a regulatory governmental body placing restrictions on the operations of a public utility or commercial enterprise is brought out so clearly that it would almost seem that every savings bank and insurance company should reprint the chapters where this is dealt with and send them to their depositors or policy holders. The chapter on "Beware of Headline Economics" is an example of how the author leads the reader to analyze current statements and to relate them to basic factors rather than phrases and slogans.

The author does not tell you all the answers although he hazards a few, sometimes as personal opinions and sometimes in a tentative manner, but always with the evidence of careful and intelligent consideration. He does raise most of the questions and he does provide some background on which to base your own judgment.

The most sophisticated speculator or the most learned economist would gain something from reading this book. The ordinary man oppressed by volumes of loud and conflicting information, some of it expressly prepared so as to be difficult to analyze, should be greatly benefited by this clear, fair, and interesting presentation of basic facts and conditions.

MAURICE E. PELOUBET

FOOL'S PROFITS, by Arundel Cotter. *Barron's Publishing Company, Inc.*, New York, N. Y. 174 pages. 1940. $2.

Last-in, first-out method of pricing inventories, scion and improved edition of the normal stock method, is here championed with lucidity, thoroughness, and compactness, to the conclusion that any other way of pricing inventory results in profits that fool the company, the stockholders, and society. At the door of Fifo (a term I shall use as the alphabetical antagonist of Lifo, standing, respectively, for first-in, first-out and last-in, first-out) is placed erraticism, deepening of the undulations in the economic cycle, and fattening of Uncle Sam's income-tax jeans, the latter because of "fool's profits" and the melon cutting such profits provoke. Lifo is extolled for its stabilizing influence, for smoothing the economic ups and downs, and for conserving working capital through diminished tax payments and dividends.

The book is a reprint of a series of articles written primarily for the business executive and student. Dedicated to our own Maurice

E. Peloubet, it has much to bestir the expert and to illumine the path of professional thinking. After laying the groundwork for Lifo on principle, and the untoward consequences of Fifo, a case study of the application of both is provided, wherein American Woolen Company, an adherent of Fifo, comes off a bad second to American Smelting and Refining Company, pioneer in this country of the normal-stock method, or National Lead Company, a veteran in the use of Lifo. The "average" method of inventorying—the tobacco industry's middle-of-the-roader between Lifo and Fifo—is also diagnosed. The territory in which Lifo can thrive is explored, to the finding that Lifo is a "natural" for the petroleum industry, and that even the highly integrated steel industry is not immune. Some tax and accounting problems flowing out of a change from first-in to last-in are discussed. With Mr. Cotter's characteristic realism, he signs off with the warning that Lifo is not the embodiment of perfection or a panacea for depressions or poor executive judgment, but rather a more precise weather vane of heydays and drab days.

The case for Lifo is pivoted around the experience of Bill Smith who sold his residence for $30,000. The house cost him $18,000, and so Bill was $12,000 to the good. However, as Bill had to have a place to live in, he bought another house like the one he sold, spending the full $30,000. Instead of being "in" $12,000, Bill was therefore right back to where he started—no, not even that. Uncle Sam clipped off $3,000 income tax on that $12,000 profit, so that after the smoke cleared, Bill was $3,000 in the dog house. The moral of the story, transferred to the business realm, is that replacement is the thing in figuring costs, where from the nature of the case, as with inventories, replacement is to be made. If $30,000 were treated as the cost of what was sold, there would be no hits of profit, no runs on the bank account, and no errors in needlessly paying taxes.

This is an engaging and forceful picture. However, Fifo needn't run for the showers. Long a hero of the fans, he would undoubtedly step briskly to the plate to clout Mr. Cotter's offerings with drives in the following fields:

(1) The purpose of accounting is to account, not to pacify economic surges or save taxes. A profit or loss lurks in every closed transaction, measured by the comparison between cost and selling price. Cost is the amount spent for the thing sold. Where, as in Bill Smith's case, the thing sold is readily identifiable, that is all there is to it and the resulting profit or loss is absolute and honest-to-goodness, unless accounting and Webster's dictionary are subverted. Bill Smith may have been foolish for selling when he knew that he had to use all of the proceeds in replacement. But having sold, he closed one chapter, and replacement started a new one. To regard the cycle as indefinitely open until Bill Smith departs this mortal earth, or no longer wants a house, is to make accounting more amiable than the facts.

(2) Fifo and Lifo logically come into the picture only where cost cannot be identified because the item sold is one of many, acquired at different times and costs. Fifo then indulges the arbitrary assumption of identifying what was sold as being what was acquired first. Lifo, with similar arbitrariness, assumes that what was sold is to be identified with the last acquisition. In the final washout, the net arithmetical result of both is necessarily the same. What is involved therefore, is, like depreciation and other thorny accounting problems, intermediate arbitrary allocation of an aggregate cost pending the final washout. If Fifo or Lifo run ahead in one year, it must give ground in another. (That holds true for taxes as well, as shown by the experience of National Lead Company and the study made by the American Mining Congress, both of which are related in the book.)

(3) Fifo claims the directional beam for this interim measurement because it yields inventories reared in terms of most recent prices, whereas Lifo reflects prices of an increasingly remote period. Then again, since Lifo "freezes" the initial prices, the time that Lifo is adopted becomes Godhead. Not so with Fifo. It is not irretrievably riveted to any time or price.

(4) Fifo assumes that goods are sold from the bottom of the pile. Lifo not only assumes that goods are sold from the top, but even supplies a pile when there is none. For example, Lifo says that the house that Bill Smith sold cost him $30,000, the cost of a house not yet owned by Bill Smith but acquired at a future date. In an industrial scene, the same result is worked where sales are first made out of opening inventory and the supply is replenished later in the year. Accounting is on quicksand when future costs determine past profits.

(5) Lifo says that Bill Smith is right back to where he started. That is true in the sense of "things"—he started with a house and ended with the same sort of house. However, our economy is a "dollar" economy, not a "thing" economy. We may be "thing" poorer, but "dollar" richer. In accounting, it is the dollar that talks, and so there is a profit. Conversely, we may be "thing" richer and "dollar" poorer. We universally designate this as a loss. It is not feasible to admeasure the underlying intrinsic "thing" situation. Our sole, common denominator and mode of expression is the dollar. Therefore, talking in the only language in which finance can express itself, the position of Bill Smith changed from owning a home costing $18,000 to owning a home costing $30,000. That is a real difference, just as in the case of two companies erecting exactly the same type of plant at the same time, one spending $18,000 and the other $30,000.

Now that our federal income-tax laws afford equal rating to Lifo as to Fifo, the battle between the two will wax warm. My prediction is that the star of Lifo is in the ascendancy—not because of the broad ground upon which it is hailed by Mr. Cotter, but because it does have an incipient tax advantage. However that may be, Mr. Cotter merits the accolade of the accounting profession for doing a bit of public-relations work par excellence, for in *Fool's Profits* we have someone outside our own ranks telling the world with unmistakable effectiveness that "cost" is a vacuum unless related to method. Let us hope that both business and accounting will profit from these soundings, and that there will emerge, as accepted and required practice, that financial statements explain the costing method. In fact, the explanatory data should be sufficiently comprehensive in terms of costs and market figures, so that a reader or analyst would be fully informed and be free to apply his own pet theory of inventory valuation and resulting profit determination.

J. S. Seidman

THE FEDERAL INCOME TAX, by Roy G. and Gladys C. Blakey. *Longmans, Green and Co.*, New York, N. Y. 640 pages. 1940. $7.50.

This book is a presentation of the genesis and development of the federal income tax with an explanation of the underlying economic and political reasons for its adoption and periodic changes. That it is authoritative and complete is evidenced from the source and nature of the material and the painstaking care exercised by the authors in delving into official congressional, court, governmental departmental records, and into unofficial but reliable contemporary publications. Pieced together by authors with such rich backgrounds of tax knowledge as the Blakey's, the book will rank high as an authoritative historical work.

Beginning with a discussion of the situation during the Civil War and leading up to the income-tax act of 1894, the changes are traced down to the present day. Significant events are sifted from the mass of economic and political developments. Each revenue act is taken in order, the recommendations of the committees, reports of conferees, the deliberations, debates, and the reasons for conflicting views and, finally, a summary of the law. In chapter XXIV, the final chapter, the authors present certain conclusions relative to the evaluation of the income tax. These conclusions seem to agree substantially with those of others familiar with the problem and contribute little new thought as to precisely how improvements should be made. This criticism, however, is overshadowed by the research significance of the work.

For accountants and lawyers actively engaged in tax practice, this book would be interesting and helpful in a general way. For laymen and students of economic and political history it would furnish absorbing reading. For instructors in political economy and taxation, it would seem to be almost indispensable.

William F. Connelly